Battle Road Research
An Independent Voice

Monday, May 21, 2012

Facebook
A Five-fold Thesis of Concern
Launching Coverage with a SELL Rating

Overview and Investment Thesis

Though **Facebook (NASDAQ: FB - $38.23)** has in less than eight years linked up nearly half of America and 13 percent of the world's population to its ubiquitous social media portal, we are launching coverage of the Menlo Park California company with a SELL recommendation, in light of its declining rate of advertising sale growth, pressure to monetize mobile use, capital expenditure intensity, questionable corporate governance, and lofty valuation. Our one-year price target is $29 per share, based on a 38 multiple assigned to our 2013 EPS estimate of $0.75. The following points summarize our concerns about Facebook.

- *Declining rate of advertising sales growth.* Though Facebook has by its own calculation signed up 900 million users around the globe who upload over 300 million photos each day, we are concerned about the company's declining rate of advertising sales growth over the last few quarters. Year over year growth has declined from 87 percent in the first quarter of 2011 to 37 percent in the first quarter of 2012. We understand that at least part of this declining growth rate stems from the contribution of international ads, which are generally of a smaller price per ad than in the US, as well as Facebook's reluctance thus far to monetize mobile use.

- *Pressure to monetize mobile.* Mobile users are the fastest growing part of Facebook's customer base, though statistics are somewhat murky regarding whether mobile is replacing—or simply complementing—desktop use. Facebook has only begun to scratch the surface in mobile advertising by offering sponsored story ads, yet must avoid alienating users by displaying annoying ads that could backfire by increasing churn, or reducing the frequency of use.

- *Cap Ex Intensity.* Like Google and Amazon.com, Facebook operates a cap ex intensive business. Facebook's capital expenditures have doubled in each of the last two years, and could triple this year, according to the company's IPO prospectus.

- *Corporate governance.* CEO Mark Zuckerberg's Class B ownership guarantees that he will exercise 56 percent of the voting rights in the company, though his ownership stake in the company is far less. While Facebook's corporate governance structure is by no means unique, we believe it lacks the kind of checks and balances that would ensure the company's interests are aligned with shareholders.

- *Estimates and Valuation.* For calendar year 2012 we project revenue of $5.3 billion and EPS of $0.55. Our estimates for 2013 call for revenue of $7.5 billion and EPS of $0.75. Trading at 51 times our 2013 EPS estimate of $0.75, we believe that Facebook shares are over-valued. We are using a one-year $29 price target based on a 38 multiple assigned to our 2013 EPS estimate. Thus, we are launching coverage of Facebook with a SELL rating.

Investment Thesis

With support for more than 70 foreign languages, and data centers or offices in 20 foreign countries, Facebook offers investors a unique play on the growing phenomenon of social media. In less than eight years the company has grown to become a truly global platform, with more than 900 people around the world sharing their thoughts, likes, dislikes, and photos with friends and family on a monthly, and, in some cases, daily basis.

Though Facebook recently crossed the $1 billion in revenue per quarter mark, and has an extremely bright future ahead of it, we are nonetheless concerned about the company's declining advertising revenue growth rate, pressure to monetize its mobile users, the capital expenditure intensity of the business, a corporate governance structure that is unfriendly to shareholders, as well as a valuation that is far from compelling.

We recognize Facebook's opportunity to generate additional ad revenue per customer, as well as the potential to grow overseas, expand into new commerce categories, and monetize its mobile users, yet our sense is that currently much of this future success may already by reflected in its share price.

Other threats to Facebook's ongoing success include an over-reliance on ad spending, a patent infringement lawsuit launched by Yahoo!, competition from Google and others, as well as the potential loss of key talent to the next venture-backed Silicon Valley startup. Overall, our sense is that Facebook is overvalued based on our expectation for ESP of $0.55 in 2012, and $0.75 in 2013. Our one year price target is $29 per share, and our rating is SELL.

Company Background and Overview

From its humble origins in 2003 as a dormitory room project of Mark Zuckerberg, then a Harvard sophomore, Facebook has blossomed to become an integral part of the lives of more than 900 million people around the globe. Facebook began when Zuckerberg and his fellow classmates hacked their way into the University's computer network to obtain photos of their fellow students, and created Facemash, an online project that allowed students to view and rate their fellow students according to various criteria. Though threatened with expulsion by Harvard administrators, charges against the students were dismissed.

The company incorporated in 2004, and, by then, based in California, began to branch out by serving other colleges, and high school students. By the end of 2005, Facebook supported over 800 college networks, and began to introduce photos into the user experience. The company recorded $9 million in sales that year, and reached an average of six million users each month.

Facebook launched Facebook Mobile the following year, and added workplace networks. In 2007, the company launched a new platform that enabled 65 developers to develop and deliver 85 Facebook applications. Facebook received its most important commercial validation in October of 2007, when Microsoft purchased a 1.6 percent stake in the company for $240 million, awarding Facebook a valuation of roughly $15 billion. Sales in 2007 were $272 million, and the company reached an average of 58 million users each month.

2008 and 2009 were years of rapid growth for the company, both in the US and abroad, as Facebook introduced chat for instant messaging, and expanded its global reach by supporting over 20 foreign languages. Revenue totaled $272 million in 2008, and MAUs reached 145 million. In 2009, the company introduced the ubiquitous "Like Button," and in May launched Facebook payments. Revenue rose to $777 million, and MAUs were 360 million. By late 2010, the company's market capitalization as measured in the illiquid market of pre-public securities, exceeded $40 billion. Mark Zuckerberg was named Time Magazine's *Person of the Year* for 2010.

With the assistance of Goldman Sachs, Facebook raised a round of capital in 2010 through a $500 million private placement of securities. Russia-based Digital Sky invested $500 million, and Goldman Sachs invested an estimated $50 million. Last year Goldman Sachs led another private investment offering of $1.5 billion, which gave Facebook a $50 billion valuation. The shares were sold overseas, in an effort not to violate US securities laws for the private placement of securities. A condition of participation in this round was reported to be that any shares purchased would be held until 2013.

In December of 2011, as a sign of the times, Facebook moved its headquarters from Palo Alto to the former Menlo Park headquarters of the once high-flying Sun Microsystems, a leader in engineering workstations. Now ensconced in a 57 acre campus with rights to an adjacent 22 acre parcel for future growth, Facebook has ample room for expansion over many years. In their new headquarters, Facebook employees work without cubicles or private offices.

In the most widely and wildly anticipated IPO in the last several years, Facebook debuted on the NASDAQ on May 18, at $38.00, the high end of an upwardly revised trading range. The company enlisted the support of Morgan Stanley, JP Morgan Chase, Goldman Sachs, and more than 30 other investment banks. Facebook sold a total of 180 million shares, raising over $6.5 billion, after deducting for investment banking fees, while existing shareholders sold 241 million shares, or about 57 percent of the shares in the offering.

Our Chief Concerns

Declining Rate of Advertising Sales Growth

Facebook has by its own calculations signed up 900 million users of its service around the globe who upload over 300 million photos each day. Facebook derives about 85 percent of its revenue from serving up display ads to users of the service. Though Facebook has been growing its user base consistently in the last several years, year over year growth rates are declining. Facebook does not provide statistics on the churn level within its installed based.

Facebook's advertising revenue contracts and campaigns are short-lived, and advertisers always have the opportunity to send their ad dollars to the next new platform. Just as Facebook may have siphoned off incremental advertising revenue from Google, it faces the same prospect if its platform fails to evolve, or something better comes along. The recent decision by General Motors to suspend its advertising on Facebook, following an internal review, underscores the fickle nature of ad spending. We fully understand that for every car company that cancels its Facebook ad campaign, there are several others who may elect to increase their ad spending on Facebook. Nonetheless, we think that Facebook will be under the gun to prove and quantify its ROI for the world's advertisers.

To our knowledge the company does not provide metrics on the level of advertising from new versus repeat customers in a given quarter. Perhaps it will once it begins to report metrics as a public company. For now, we are left to speculate the reasons for the declining rate of growth. Year over year growth has declined from 87 percent in the first quarter of 2011 to 37 percent in the first quarter of 2012. We understand that at least part of this

declining rate of growth stems from the contribution of international ads, which generally generate lower fees than in the US, as well as Facebook's reluctance to monetize mobile use.

Pressure to Monetize Mobile Use

Mobile users are the fastest growing part of Facebook's customer base, though statistics are somewhat murky regarding the percentage of users that access both desktop PCs and mobile devices to interact with Facebook. Facebook has only begun to scratch the surface in mobile advertising by offering sponsored story ads, yet it will face a difficult challenge not to alienate users by serving up irrelevant and annoying ads that could backfire by increasing customer churn and reducing the frequency of use. As of the most recent quarter Facebook claims over 488 million MAUs utilizing mobile products, or a bit more than half of its user base globally. The company suspects that these mobile users complement desktop users, yet Facebook acknowledges that there may be a substitution effect, whereby a certain percentage of its customers have already—or may be about to—switch to smartphones and tablets exclusively.

Cap Ex Intensity

Facebook's capital expenditures more than doubled between 2010 and 2011 from $293 million to $606 million. During the first quarter of 2012, Facebook's capital expenditures nearly tripled, rising from $153 million in the year ago period, to $453 million. In 2012, the company intends to spend anywhere from $1.6 billion to $1.8 billion, some of which may be financed through leasing arrangements with other data centers.

Undoubtedly the willingness to host an unlimited number of pictures and videos adds up quickly, and requires additional bandwidth, storage, computer servers, and leases, which are required to house and display this data to its customers. While our model calls for $2.6 billion in operating income in 2012—more than enough to offset even the high end of anticipated cap ex—investors will want to monitor the level of free cash flow generated by the company as an important barometer of its ability to generate long term returns.

Corporate Governance

Mimicking the moves of Google, Groupon, LinkedIn, and Zynga, Facebook has followed in their corporate governance footsteps by awarding CEO Mark Zuckerberg a special class of shares that guarantees his ability to maintain a majority of the voting rights in the company. Combined with the titles of Chairman and CEO, we believe that the corporate governance

structure grants undue power to a single person, and a virtual lock on all major decisions affecting publicly-traded Facebook. Our view is that while Facebook is not alone in its decision to provide the Chairman with this level of voting power, our view is that the corporation lacks the kind of checks and balances that would ensure Facebook's interests are aligned with shareholders.

Valuation

Upon a thorough review of the company's financial results as presented in its IPO prospectus, combined with our assessment of the company's revenue and earnings prospects over the next couple of years, we project revenue of $5.3 billion and EPS of $0.55 for calendar year 2012. Our estimates for 2013 call for revenue of $7.5 billion and EPS of $0.75. Facebook trades at 69 times our 2012 EPS estimate, and 51 times our 2013 EPS estimate. Facebook also trades at an EV-to-sales ratio of just below 20, based on our projected revenue estimate of $5.3 billion for 2013.

Opportunities and Threats

Opportunities

Gaining a Larger Share of Customers' Ad Spending

While much has been made of General Motors' recent decision to cancel as much as $10 million annually on its Facebook ad campaign, the fact that GM spends an estimated $1.8 billion annually on ad spending illustrates the potential for Facebook to grow if it can meet its customers' requirements and demonstrate that their ROI is on par with other ad platforms like print, television, and radio. We believe that elemental metrics regarding new versus repeat advertising customers in the quarter would provide insight into analyzing the company's performance and prospects.

Further Geographic Expansion

Facebook has done an exceptional job of growing in the US and western Europe, and has become increasingly successful in other foreign markets in the last few years, as 80 percent of Facebook users are located outside of the US and Canada. Time will tell the extent to which the populations of India, Brazil, Russia and India embrace Facebook as their favored social media platform. China is not a significant revenue source for Facebook. To be sure, Facebook is not alone for its quest to enter China. US internet companies face a combination

of legal, cultural and language barriers as they seek to gain access to the Chinese market. Time will tell whether indigenous companies like Renren will dominate China, or whether Facebook, like Apple, will gain access to the Chinese market.

Monetizing Mobile

Much of Facebook's future success rides on its ability to figure out how to monetize advertising on mobile platforms, such as smartphones, and tablet computers. The challenge is: how to cultivate its user base during the transition from desktop to mobile devices without forever alienating them by serving up nettlesome and annoying ads. While the argument can be made that Facebook has failed to harvest the emerging market for mobile ad spending, which is already over $1.5 billion on a global basis, the company has not yet displayed ads through its mobile websites.

Beginning in March of 2012, however, Facebook does display "sponsored stories" in its users' news feeds. Facebook has also made several acquisitions to position itself to enter the mobile market. In April of 2011, the company acquired Snaptu, an Israeli-based software developer for an estimated $40-70 million. Snaptu provided smartphone-like features like photo sharing for the estimated 70 percent of the world that does not use smartphones. Thus, Nokia, LG, and Sony Ericsson customers can access web-like applications like Facebook and Twitter on over 2,500 devices, including 80 percent of all cell phones sold world wide. Other acquisitions in the last 18 months include Rel8tion, which has developed a location and demographics-based ad targeting tool for mobile devices.

In April of 2012, Facebook announced its intent to buy Instagram, an 18-month old start up focused on free photo sharing. Venture-backed Instagram reaches an estimated 30 million active users, with a photo sharing app specifically designed for mobile users. The company employed just 13 people, and, as best we can tell, generates no revenue. Facebook plans to pay $300 million in cash, plus 23 million shares of post-IPO stock, and intends to maintain Instagram's products as separate mobile applications. The acquisition is subject to HSR review and is expected to close in 2012. Facebook has agreed to pay a $200 million termination fee to Instagram if the US government prevents the completion of the sale, or if either party terminates the agreement after December 10, 2012.

Opportunity to Monetize Additional Goods and Services

15 million Facebook users purchased virtual goods using Facebook payments in 2011. Curiously, the Facebook platform has been consigned largely to the sale of digital, that is to say "virtual goods" through Zynga. We would expect Facebook to devise a strategy to help

the more than four million businesses that list on its pages to sell goods and services, with FB collecting the same 30 percent fee that it collects for Zynga-related products and services.

Facebook recently announced Facebook Offers, allows Facebook users to redeem offers made by businesses. When a user ‘likes’ a business ‘Page’, the user will receive notifications regarding offers made by the business. Last month, Facebook acquired Tagtile, a San Francisco-based startup that provides loyalty rewards and mobile marketing for an undisclosed amount. Tagtile provides a mobile application that allows customers to tap their phones on the Tagtile Cube, a no-cost hardware device provided to partnered merchants, to receive coupons and other loyalty rewards.

Other Threats

Competition

Facebook faces competition from Google, as well as indigenous competitors in local markets, such as vKontakte in Russia. Like Google and other US internet providers, Facebook faces restricted access in China, where the social networking scene is dominated by indigenous provider Renren.

Google currently offers Google Plus, a social networking tool that it launched in 2011. Google Plus is Google’s fourth attempt to enter the social networking space and all signs are that the company remains committed to trying to figure out user requirements in this market. In addition to expanding the use of Google Plus, Google has integrated some of its features into Gmail, a much larger platform, which serves an estimated 400 million users. Google also operates Google Brazil, which derives from Orkut, a social media platform founded in 2004. The site has an estimated 60 million users around the world, with about half in Brazil, and another 20 percent in India.

Through its acquisition of Motorola Mobility Google is extending its influence from mobile phone and tablet operating systems to devices. The combination of Google’s search engine process and influence with advertisers, as well as its email engine, guarantees that Google will give Facebook a run for its money for years to come.

VKontakte, a Russian social networking service, was founded in 2006 and may have as many as 120 million users. VKontakte is reportedly similar to Facebook in terms of features and layout, but has a unique feature that allows users to share large files. VKontakte’s popularity has spread rapidly, as it has grown from one million registered users in 2007 to over 100 million users in just five years. About 70 percent of vKontakte’s registered users are from Russia, and while the company claims to be the largest social networking site in Europe, it

has not generated significant traction outside of Eastern Europe. VKontakte generated $94 million in revenues in 2010 and around $120 million in 2011. Like Facebook, VKontakte generates revenue primarily through display ads. A recent Mail.ru Group investment in VKontakte suggests the company is valued at $1.5 billion. There is speculation that VKontakte will launch an IPO sometime in 2012, following in Facebook's footsteps.

Renren (NYSE: RENN - $5.93) is China's premiere social networking website. Founded in December of 2005 under its former name, Xiaonei Network, Renren dominates the Chinese market with over 152 million accounts as of its March 2012 quarter. Despite having functions similar to Facebook, Renren must comply closely with government restrictions. Specifically, Renren is not allowed to post materials deemed politically-incendiary to the Chinese government. Also, Renren's reach is extremely limited to China, but with around 1.4 billion people in the country, the company still has significant growth potential. Renren generates revenue through 1) advertisements and 2) internet value-added services (IVAS), which includes mainly gaming revenues. Renren generated $32.1 million in revenues during its Q1'12, $9.3 million from advertising and $22.8 from IVAS (with $17.5 million from gaming). For 2011, Renren generated $118 million in revenues, up 53 percent from $77 million in 2010.

In contemplating a move into China, Facebook faces significant obstacles, as the Chinese government is reluctant to see the mass public unduly influenced by western culture, and the government is quite strict when it comes to freedom of speech. Facebook's open-forum styled platform would face close scrutiny by Chinese authorities, just as Google received push-back from the Chinese government. Due to a lack of competition in China as a result of its government's restrictions, we think Renren poses a tremendous obstacle for Facebook, given its established brand presence, website, and extensive user network.

Privacy Laws

Since its inception, Facebook has faced concerns expressed by right to privacy advocates, who note the sensitivity of user data and privacy settings that the company captures. In 2011 Facebook entered into a 20 year settlement with the FTC to resolve investigation of these issues. As a condition of the settlement, Facebook must adhere to bi-annual privacy audits.

The privacy issue is not simply endemic to Facebook, but touches upon all internet advertising companies that collect and disseminate user details to advertisers. It is conceivable that Facebook will face more pressure to share more details about its user habits and preferences in an effort to gain a higher percentage of its customers' advertising dollars.

Patent Infringement

In March of 2012, just two months before Facebook's IPO, Yahoo! suddenly decided to sue Facebook for infringing upon ten patents relating to social networking, customization, user privacy, advertising, and messaging. It is difficult for us to determine how seriously we should take Yahoo's patent infringement claims. We note that Yahoo! sued Google shortly before its IPO and that Google agreed to settle with Yahoo shortly thereafter.

In April 2012 Facebook entered into an agreement with Microsoft, under which Facebook will be assigned Microsoft's rights to about 615 US patents, as well as 170 foreign patents subject to agreement between AOL and Microsoft in exchange for $550 million. Facebook will also receive a non-exclusive license to additional AOL patents that Microsoft has purchased, and Facebook will grant Microsoft a non-exclusive license to the AOL patents acquired by Facebook. The transaction is subject to the completion of Microsoft's transaction with AOL, as well as US government review under HSR.

Loss of talent to the Next Silicon Valley Start Up

Just as Facebook has been successful in luring away COO Sheryl Sandburg from Google, as well as other key talent from Google and other Silicon Valley firms, Facebook faces the prospect of losing key talent to the next hot startup in Silicon Valley, particularly since two-thirds of Facebook's employee base is located there. All indications are that the company is building an open and collegial corporate culture. Facebook has also recently opened an office in the Seattle area, an indication that it might be willing to diversify its employee base geographically.

Financial Analysis, Projections, and Valuation

Facebook's revenue is comprised of advertising, 85 percent for the full year of 2011, and payments and other fees, the remainder. Advertising revenue comes from display ads, while payments come from the sale of virtual goods in connection with social media game sites, principally from **Zynga (NASDAQ: ZNGA)**, which accounted for 12 percent of sales in 2011. Facebook recorded total revenue of $3.7 billion in 2011, an increase of 88 percent over 2010. The company's advertising revenue grew by 69 percent over 2010 to reach $3.1 billion. The company noted an 18 percent increase in the average price per ad delivered in 2011.

Payments and other fees, 15 percent of sales for 2011, grew almost five-fold, to reach $557 million. Total revenue from the US was 46 percent in 2011, with the remaining 54 percent from international markets, primarily Western Europe, Canada and Australia. Thus, US

revenue grew by 70 percent in 2011, while international sales grew by 120 percent, reaching $1.6 billion.

Facebook recorded $1.06 billion in revenue in the first quarter of 2012, an increase of 45 percent over the prior year. Advertising revenue, 82 percent of sales, rose by 37 percent over the prior year. Payments and other fees, chiefly revenue from Zynga, rose by 98 percent to $186 million, or nearly 18 percent of total sales. The company's gross margin was 74 percent, compared to 77 percent in the prior year, reflecting, we suspect, a higher contribution from payments and other fees (Facebook does not break down gross margin by revenue category). Facebook's operating margin was 46 percent, compared to 54 percent in the prior year, as operating expenses grew by 78 percent over the prior year, decisively outpacing sales growth. EPS was $0.10, versus $0.08 in the prior year. Our estimates exclude stock-based compensation and utilize a 37 percent tax rate.

Facebook's balance sheet prior to the IPO was extremely solid, with $3.9 billion in cash and investments, and zero debt, coupled with a conservative current ratio of 4.8. Post IPO, Facebook's cash balance has swelled to over $10 billion. At the end of the March quarter, the company had accounts receivable Days Sales Outstanding (DSO) balance of 41, slightly lower than the 44 level at the end of the prior quarter.

Like Google, Facebook's business model features a high level of capital expenditure intensity, chiefly investments in computers and data storage infrastructure, required to house and display the profile data and pictures of its 900 million monthly actively users. Capital expenditures more than doubled between 2010 and 2011 from $293 million to $606 million. In 2012, the company intends to spend anywhere from $1.6 billion to $1.8 billion. Historically, the company has rented space in others' data centers, but it opened its first data center built from the ground-up in Pinesville, Oregon in April of 2011.

Projections and Valuation

For 2012, we forecast revenue of $5.3 billion, a 43 percent increase over 2011. Our EPS estimate is $0.55. Note that we are using a 37 percent tax rate assumption, and that we are excluding stock based compensation and amortization charges. Our 2012 estimates assume an operating margin of 49 percent for the year, down from the prior year's 53 percent. For 2013, we project revenue of $7.5 billion, an increase of 41 percent over 2012, and an operating margin of 50 percent, which yields EPS of $0.75, or 36 percent growth over 2012.

Conclusion

Though Facebook has by its own calculations signed up 900 million users around the globe who upload over 300 million photos each day, we are concerned about the company's

declining rate of advertising sales. Facebook has only begun to scratch the surface in mobile advertising by offering sponsored story ads, yet it will face a difficult challenge not to alienate users by displaying annoying ads that could backfire by increasing churn, and reducing the frequency of use. Facebook's business is cap ex intensive, as capital expenditures have doubled in each of the last two years, and could triple this year, according to the company's IPO prospectus.

While Facebook's corporate governance structure is by no means unique, we believe it lacks the kind of checks and balances that would ensure the company's interests are aligned with shareholders. For calendar year 2012 we project revenue of $5.3 billion and EPS of $0.55. Our estimates for 2013 call for revenue of $7.5 billion and EPS of $0.75. Trading at 51 times our 2013 EPS estimate of $0.75, we believe that Facebook shares are over-valued. We are using a one-year $29 price target based on a 38 multiple assigned to our 2013 EPS estimate. Thus, we are launching coverage of Facebook with a SELL rating.

Facebook

($ millions, except EPS and %)

Notes:
1) We exclude stock compensation and other one-time charges.
2) We assume a 37% tax rate.

Battle Road Research
(781) 894-0705
www.Battleroad.com

	FY10(A)			FY11(A)			(A)		FY12(E)					FY13(E)		
	Year	Mar-11	Jun-11	Sep-11	Dec-11	Year	Mar-12	Jun-12	Sep-12	Dec-12	Year	Mar-13	Jun-13	Sep-13	Dec-13	Year
REVENUES	1,974	731	895	954	1,131	3,711	1,058	1,280	1,358	1,602	5,298	1,503	1,809	1,920	2,247	7,479
Advertising	1,869	637	776	798	943	3,154	872	1,048	1,069	1,264	4,253	1,177	1,414	1,444	1,706	5,741
Payments & Other Fees	105	94	119	156	188	557	186	232	289	338	1,045	326	394	476	541	1,738
Cost of revenues	493	167	207	233	244	851	273	320	326	384	1,303	376	452	480	557	1,865
GROSS PROFIT	1,481	564	688	721	887	2,860	785	960	1,032	1,218	3,994	1,127	1,357	1,440	1,690	5,613
Sales and marketing	182	68	92	108	116	384	136	154	156	176	622	165	197	209	243	814
Research and development	134	53	64	75	82	274	93	106	109	128	436	117	141	150	175	583
General and admin	113	48	61	54	66	229	72	81	86	101	339	90	109	115	130	444
Total Operating Expense	429	169	217	237	264	887	301	340	350	405	1,397	373	447	474	548	1,842
OPERATING INCOME	1,052	395	471	484	623	1,973	484	619	682	812	2,597	754	910	966	1,142	3,771
Int./other inc. (expense)	-24	-10	-17	-17	-17	-61	1	15	45	45	106	45	45	45	45	180
Income before taxes	1,028	385	454	467	606	1,912	485	634	727	857	2,703	799	955	1,011	1,187	3,951
Income taxes	402	140	152	172	230	695	177	235	269	317	998	296	353	374	439	1,462
NET INCOME	626	245	302	295	376	1,217	308	400	458	540	1,705	504	602	637	748	2,489
Avg. shares outstanding	2,796	2,906	2,906	2,906	2,906	2,906	2,936	3,116	3,166	3,216	3,109	3,266	3,316	3,366	3,416	3,341
EPS (Fully taxed)	0.22	0.08	0.10	0.10	0.13	0.42	0.10	0.13	0.14	0.17	0.55	0.15	0.18	0.19	0.22	0.75
Yr-to-Yr % Change																
Total Revenues	154.1%	111.9%	107.7%	104.3%	54.7%	88.0%	44.7%	43.0%	42.3%	41.6%	42.8%	42.0%	41.3%	41.4%	40.3%	41.2%
Advertising		87.4%	83.0%	77.3%	44.0%	68.8%	36.9%	35.0%	34.0%	34.0%	34.8%	35.0%	35.0%	35.0%	35.0%	35.0%
Payments & Other Fees		NM	NM	817.6%	147.4%	430.5%	97.9%	95.0%	85.0%	80.0%	87.6%	75.0%	70.0%	65.0%	60.0%	66.3%
Operating Expense	61.9%	116.7%	123.7%	104.3%	91.3%	106.8%	78.1%	56.9%	47.8%	53.5%	57.5%	23.8%	31.3%	35.3%	35.3%	31.8%
Earnings per share	138.9%	135.5%	116.7%	110.1%	40.8%	87.1%	24.6%	23.5%	42.6%	29.8%	31.0%	47.0%	41.4%	30.8%	30.3%	35.8%
Sequential Growth																
Total Revenues		0.0%	22.4%	6.6%	18.6%		-6.5%	20.9%	6.1%	18.0%		-6.2%	20.4%	6.1%	17.1%	
Advertising		-2.7%	21.8%	2.8%	18.2%		-7.5%	20.1%	2.1%	18.2%		-6.8%	20.1%	2.1%	18.2%	
Payments & Other Fees		23.7%	26.6%	31.1%	20.5%		-1.1%	24.8%	24.4%	17.3%		-3.8%	21.2%	20.7%	13.7%	
As a % of Sales																
Gross profit	75.0%	77.2%	76.9%	75.6%	78.4%	77.1%	74.2%	75.0%	76.0%	76.0%	75.4%	75.0%	75.0%	75.0%	75.2%	75.1%
Advertising	94.7%	87.1%	86.7%	83.6%	83.4%	85.0%	82.4%	81.9%	78.7%	78.9%	80.3%	78.3%	78.2%	75.2%	75.9%	76.8%
Payments & Other Fees	5.3%	12.9%	13.3%	16.4%	16.6%	15.0%	17.6%	18.1%	21.3%	21.1%	19.7%	21.7%	21.8%	24.8%	24.1%	30.3%
Sales and marketing	9.2%	9.3%	10.3%	11.3%	10.3%	10.3%	12.9%	12.0%	11.5%	11.0%	11.7%	11.0%	10.9%	10.9%	10.8%	10.9%
Research and development	6.8%	7.3%	7.2%	7.9%	7.3%	7.4%	8.8%	8.3%	8.0%	8.0%	8.2%	7.8%	7.8%	7.8%	7.8%	7.8%
General and admin	5.7%	6.6%	6.8%	5.7%	5.8%	6.2%	6.8%	6.3%	6.3%	6.3%	6.4%	6.0%	6.0%	6.0%	5.8%	5.9%
Operating profit	53.3%	54.0%	52.6%	50.7%	55.1%	53.2%	45.7%	48.4%	50.2%	50.7%	49.0%	50.2%	50.3%	50.3%	50.8%	50.4%
Income before taxes	52.1%	52.7%	50.7%	49.0%	53.6%	51.5%	45.8%	49.6%	53.5%	53.5%	51.0%	53.2%	52.8%	52.6%	52.8%	52.8%
Net income	31.7%	33.5%	33.7%	30.9%	33.2%	32.8%	29.1%	31.2%	33.7%	33.7%	32.2%	33.5%	33.3%	33.2%	33.3%	33.3%
Tax rate	39.1%	36.4%	33.5%	36.9%	38.0%	36.3%	36.5%	37.0%	37.0%	37.0%	36.9%	37.0%	37.0%	37.0%	37.0%	37.0%

Note: Fiscal Year Ends December 31.

5/17/2012

Facebook

Balance Sheet
($ in millions, except Key Ratios)

Battle Road Research
(781) 894-0705
www.Battleroad.com

	Dec-11	Mar-12
Assets:		
Cash and cash equivalents	1,512	1,282
Marketable securities	2,396	2,628
Accounts receivable, net	547	482
Prepaid revenue share, other assets	149	627
Total Current Assets	4,604	5,019
Property and equipment, net	1,475	1,855
Goodwill and intangible assets	162	189
Other assets	90	121
Total Assets	6,331	7,184
Liabilities:		
Accounts payable	63	129
Platform partners payable	171	178
Accrued expenses & other current liab.	296	337
Deferred revenue and deposits	90	93
Current portion of capital lease obligations	279	302
Total Current Liabilities	899	1,039
Capital lease obligations, less current	398	404
Long term debt	0	0
Other liabilities	135	144
Total Liabilities	1,432	1,587
Shareholders' Equity	4,899	5,597
Total Liabilities & Equity	6,331	7,184
Key Assumptions and Ratios:		
Current Ratio	5.1	4.8
Cash/ST Investments % of Total Assets	61.7%	54.4%
Cash and Securities/Share	$1.34	$1.33
Tangible Book Value/Share	$1.63	$1.84
Accounts Receivable DSO	44	41
Return On Equity (TTM)	34.5%	22.9%

05/17/12

Table 1: Facebook Comparative Valuation

Company	Ticker	Price 5/17/12	Mkt Cap $M	FY'12 Rev. $M(E)	FY'13 Rev. $M(E)	FY'13 Rev. Growth	FY'12 EV/Sales	EPS 2012(E)	EPS 2013(E)	P/E 2012(E)	P/E 2013(E)	PEG 2013(E)
Google	GOOG	$600.40	195,730	35,450	42,250	19%	4.3	$43.39	$50.52	13.8	11.9	0.7
Yahoo	YHOO	$15.42	18,840	4,470	4,610	3%	3.8	$0.94	$1.08	16.4	14.3	1.0
LinkedIn	LNKD	$99.00	10,989	907	1,350	49%	11.4	$0.68	$1.24	145.6	79.8	1.0
Zynga	ZNGA	$7.16	5,270	1,460	1,760	21%	2.9	$0.27	$0.37	26.5	19.4	0.5
Pandora	P	$9.39	1,560	417	607	46%	3.5	-$0.17	$0.03	NM	NM	NM
Peer Median			*10,989*			*21%*	*3.8*			*21.5*	*16.8*	*0.8*
Facebook	**FB**	**$38.23**	**119,125**	**5,298**	**7,479**	**41%**	**20.5**	**$0.55**	**$0.75**	**69.7**	**51.3**	**1.4**

Source: Battle Road Research and Consensus Estimates.

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